

Adjustments to the selling price of coal, based on the sulfur content of the coal, are subject to sales tax. See 86 Ill. Adm. Code Section 130.401. (This is a PLR.)

July 19, 2006

Dear Xxxxx:

This letter is in response to your letter dated January 12, 2005, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.1120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to ABC for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither ABC nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

On behalf of our client, ABC, we request a private letter ruling that, under the circumstances described below, premiums ABC pays for the right to purchase low-sulfur content coal are not subject to Illinois sales and use tax.

Material Facts

ABC is an independent power producer operating coal-fired plants in Illinois. The company buys fuel for these plants from out-of-state suppliers. The coal purchase contracts contain a 'sulfur guarantee,' providing that if the sulfur content of a shipment is above a designated level, the vendor grants ABC a price concession, but that if the sulfur content is below that level, ABC pays the vendor a premium, indexed to the market price of the sulfur dioxide (SO₂) emission allowance ABC would have needed had the vendor shipped higher-sulfur content coal. The premium is billed as a separate item on the invoice from the coal vendor. ABC asks whether the premium it pays to acquire lower-sulfur content coal is subject to sales and use tax.

Statement of Authorities

The use tax is imposed on the use or consumption in Illinois of tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. The sales tax is imposed on retailers of tangible personal property. 35 ILCS 120/2. The premium is not subject to either tax because it represents payment for an intangible: the right to acquire lower-sulfur content coal. In ST 00-0084 (Apr. 12, 2000), a ruling directly on point, the Department stated that sales of SO₂ allowances are nontaxable. The taxpayer was buying coal for use at a power plant in Illinois. The supply contract specified an FOB mine price for the coal, and had a separate line item for the price of SO₂ allowances. The Department stated that sales of allowances are nontaxable because their sale usually involves no transfer of tangible personal property. The facts are virtually identical here and this ruling should control.

We found only a single ruling even arguably contrary to ABC's view. In ST 99-0034 (Oct. 20, 1999), the taxpayer, a seller of industrial, medical and specialty gases, instituted a 'Hazardous & Regulatory Compliance' (HRC) charge to offset costs associated with regulatory compliance, and added the charge to customer delivery tickets. The Department found that the charge was simply an overhead cost, and ruled that HRC charges collected from retail customers must be included in the retailer's taxable gross receipts. This ruling is factually distinguishable and there is ample authority that the premium is nontaxable as the economic and financial equivalent of an actual SO₂ allowance.

Unlike the HRC charge in the ruling, which merely represented the taxpayer's cost of regulatory compliance, the premium ABC pays for the coal in question does not represent any compliance cost of the coal vendor. Indeed, unlike the taxpayer in the ruling, which evidently was subject to various fees in connection with its handling and sale of hazardous gases, the coal vendors supplying ABC are not liable for sulfur dioxide emission requirements, and do not pay any SO₂ fees in connection with the mining, sale or use of the coal at issue.

The opinion in *Jl Aviation, Inc. v. Department of Revenue*, 335 Ill. App. 3d 905 (1st Dist. 2002) is instructive in that it directs the Department to give great weight to the business and economic substance of ABC's coal purchases in determining their sales and use tax consequences. The taxpayer, Jl Aviation, entered an agreement to purchase an aircraft from Richland Development. The agreement permitted Richland to receive the purchase price and transfer title through Nationsbanc Leasing as a means of effectuating a tax free, like-kind exchange under IRC § 1031.

The Department proposed assessing Jl Aviation with use tax for the company's acquisition of title to the aircraft from Nationsbanc. Jl Aviation protested on the ground that it was Richland, not Nationsbanc, that in substance sold the plane, and that, because Richland was not engaged in the business of selling aircraft, the transaction was nontaxable as an 'isolated or occasional' sale. An administrative law judge ruled against Jl Aviation, concluding that the company erred in elevating the substance over the form of the transaction.

Jl Aviation appealed and the circuit court reversed, reasoning that 'economic realities determine tax consequences,' and finding that the substance over form doctrine compels the State to overlook Richland's use of Nationsbanc, the IRC § 1031 conduit, in transferring the aircraft to Jl Aviation. The Department then appealed, arguing that the

form of the transaction was controlling and that because Nationsbanc regularly engaged in aircraft sales (as an institutional conduit), the isolated sale exemption did not apply.

The appeals court disagreed. In ruling for JI Aviation, the court found that Nationsbanc was not the 'retailer' in the true sense of the word because, as a pure conduit, Nationsbanc never had an economic interest in the aircraft, and held title to the asset for but (literally) one minute before conveying it to JI Aviation. Thus, because Richland was not engaged in selling aircraft, and because Richland, and not Nationsbanc, was in substance the retailer, the court found, the transaction involved an isolated or occasional sale and was therefore not subject to tax.

There is additional precedent for ABC's position that the economic substance of its coal purchase transactions is controlling. In *Young v. Hulman*, 39 Ill. 2d 219 (Ill. 1968), the Department sought to hold a mobile home dealer accountable for retailers' occupation taxes in connection with the dealer's so-called 'agency sales,' i.e., sales where third parties asked the taxpayer to find a buyer for their vehicles. The dealer argued that these transactions were nontaxable insofar as it received only a brokerage fee and did not perform an agency sale under the Department's special brokerage rules.

The court rejected this contention. In so doing, the court declared that it 'must look to the substance rather than the form of a transaction' and found that 'the characterization given to a relationship by the interested parties is not conclusive of the nature of the relationship.' Thus 'looking to the essence' of the sales, the court discounted the terms of the brokerage agreements (showing the sales as occurring outside the regular course of the dealer's business) and concluded that the transactions involved nothing more than a dealer selling mobile homes at retail for principals not themselves engaged in this business.

These authorities support the proposition that the substance—and not the form—of a transaction is controlling, and that the low-sulfur coal premium is therefore nontaxable. As shown in the enclosed 'price and price adjustments' clause (from the coal supply contract), the premium is indexed to the price of the (intangible) SO₂ allowance ABC would need if the coal supplier ships a higher sulfur content mineral. In substance, the premium is therefore the economic and financial equivalent of an actual emission allowance. Thus, 'looking to the essence' of the fuel supply arrangement, as under *Jl Aviation* and *Young v. Hulman*, it is clear that, like with the power producer in ST 00-0084, the premium represents ABC's payment for a nontaxable intangible.

Regulation Section 1200.100(b) Disclosures

Our client is not under Department audit and is not involved in litigation with the agency. To the best of our knowledge, and the best knowledge of our client, the Department has never ruled on this or any similar issue for our client or any of its predecessors. Our client has never submitted and then withdrawn a request for a ruling on this issue. A power of attorney authorizing me to make this request is enclosed.

Finally, we ask that if you are unable to grant the ruling requested, you kindly notify us in advance. Feel free to call with questions or comments.

DEPARTMENT'S RESPONSE

You have asked whether the premium paid to acquire lower-sulfur content coal is subject to sales and use tax or is the purchase of an intangible not subject to sales tax.

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2 (1998 State Bar Edition). The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3 (1998 State Bar Edition).

As you have noted, the Department has previously issued a General Information Letter stating that "sales of emission allowances are generally not subject to Retailers' Occupation Tax because their sale usually involves no transfer of tangible personal property." See letter ruling ST 00-0084-GIL. However, upon reviewing the facts that you have presented, including a review of the invoices for the coal, the Department disagrees that the charges at issue are for sales of intangibles. The invoices and the section of the sale agreement provided with your letter list these charges as "quality adjustments" in regards to the sale of the coal. It appears that the allowances (as described in your letter as "price concessions" or "premiums") are simply adjustments to the selling price of the coal based upon the quality (sulfur content) of the coal being sold. As a result, we believe that the premiums or quality adjustments paid by abc are part of the selling price of the coal, and abc incurs Use Tax on those payments.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

If you have further questions concerning this Private Letter ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote
Associate Counsel

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